

Message Text

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ACTION ARA-06

INFO OCT-01 SS-14 ISO-00 NSC-05 NSCE-00 INR-05 CIAE-00

EB-03 SP-02 OMB-01 PRS-01 /038 W

----- 057191

R 132115Z AUG 75

FM AMEMBASSY MEXICO

TO SECSTATE WASHDC 9407

C O N F I S E N T I A L SECTION 1 OF 2 MEXICO 7205

LIMDIS

E.O. 11652: GDS

TAGS: EFIN, MX

SUBJ: MOUNTING CONCERN OVER MEXICOS ECONOMIC PROSPECTS

REF: A) A298, 7/29/75; B) MEXICO 7040

1. SUMMARY: CONCERN OVER THE SHORT-TERM ECONOMIC OUTLOOK IN MEXICO IS INCREASING. THIS CONCERN HAS BEEN PRIVATELY AND/OR INDIRECTLY EXPRESSED FOR THE MOST PART, BUT PUBLIC FIGURES AND NEWSPAPERS ARE BEGINNING TO COMMENT. THE GOM, OR AT LEAST PARTS OF IT, APPEAR WORRIED THAT THIS CONCERN COULD SPREAD AND CAUSE A LOSS OF CONFIDENCE IN FOREIGN PRIVATE CAPITAL MARKTES AND, PERHAPS, ANOTHER RUN ON THE PESO BY MEXICANS FEARING A DEVALUATION. WE BELIVE THE CONCERN IS JUSTIFIED AND THAT CORRECTIVE MEASURES ARE NEEDED. THE GOM IS APPARENTLY DIVIDED ON HOW TO COPE WITH THE SITUATION, AND GOING INTO THE PRESIDENTIAL SELECTION AND ELECTION YEAR MAKES TOUGH ECONOMIC POLICY DECISIONS MORE DIFFICULT TO TAKE. CONSEQUENCES OF A CONTINUTATION OF PRESENT TRENDS COULD BE A DEVALUATION AND/OR REQUEST FOR IMG, AND POSSIBLY USG FINANCIAL ASSISTANCE. A MORE DRASTIC AND MORE REMOTE POSSIBILITY WOULD BE CHANGES IN LONG-STANDING MEXICAN ECONOMIC POLICIES GEARED TO DIVORCE MEXICO FROM ITS DEPENDENCE IN FOREIGN CAPITAL MARKETS. END SUMMARY.

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2. RECENT ECONOMIC TRENDS HAVE BEEN DISTURBING TO CLOSE

OBSERVERS OF MEXICAN ECONOMY. FOREMOST AMONG THESE IS ACCELERATION IN RATES IN INFLATION. CONSUMER PRICE INDEX ROSE 1.7 PERCENT IN JUNE; WHOLESALE PRICE INDEX ROSE 2.3 PERCENT.

INCREASES IN PREVIOUS MONTHS WERE 1.3 PERCENT AND 2.0 PERCENT RESPECTIVELY. WPI INCREASED 8.3 PERCENT FROM DECEMBER TO JUNE. PRICE RISES REFLECT MONEY SUPPLY INCREASES (9.7 PERCENT ON SEASONALLY ADJUSTED BASIS FROM END-DECEMBER TO END-MAY AND 22.9 PERCENT FROM MAY TO MAY) WHICH IN TURN APPEAR TO REFLECT CENTRAL BANK CREDIT TO THE PUBLIC SECTOR. THE PUBLIC SECTOR IS NOT EXPECTED TO CURTAIL ITS SPENDING AS THE SPENDING MINISTRIES ARE ANXIOUS TO COMPLETE PROJECTS BEFORE THE END OF THIS ADMINISTRATION AND THE PRESIDENCE BELIEVES A REAL GROWTH RATE OF AT LEAST 4 PERCENT IS NECESSARY TO MAINTAIN POLITICAL STABILITY. GROWTH IS BEING GENERATED LARGELY BY THE PUBLIC SECTOR AS PRIVATE SECTOR INVESTMENT REMAINS STAGNANT TO THE BEST OF OUR KNOWLEDGE AND OUTPUT IN THE PRIVATELY-OWNED INDUSTRIAL SECTOR MAY BE FLAT OF SHOWING LITTLE GROWTH IN REAL TERMS.

3. THE BALANCE OF PAYMENTS DEFICIT ON CURRENT ACCOUNT IS LIKELY TO REACH \$3.5 BILLION IN 1975, (UP FROM OUR EARLIER ESTIMATE OF \$3 BILLION) COMPARED TO \$2.6 BILLION IN 1974. AT THE BEGINNING OF THE YEAR, A LEVELING OFF OR REDUCTION OF THE CURRENT ACCOUNT DEFICIT WAS WIDELY EXPECTED. THE JULY 12 PROGRAM TO REDUCE THE TRADE DEFICIT APPEARS TO HAVE BEEN PUT TOGETHER VERY HASTILY AND IS WIDELY THOUGHT TO BE INEFFECTIVE AT LEAST IN THE SHORT-TERM. BOTH THE SHORTCOMINGS OF THE PROGRAM AND THE SENSITIVENESS OF THE CURRENT SITUATION WERE REVEALED WHEN GOM OFFICIALS TOLD US (REF B), THAT THEY INTEND TO REPLACE RECENTLY IMPOSED QR'S WITH A 5 PERCENT SURCHARGE BUT ARE AFRAID IT WILL BE MISINTERPRETED AS DISGUISED DEVALUATION. OIL EXPORTS IN 1975 WILL NOT BE ADEQUATE TO OFFSET THE DETERIORATION IN OTHER BALANCE OF PAYMENTS ACCOUNTS. MEXICO'S ABILITY TO ABSORB IMPORTS IS IMMENSE AND IMPORTS ARE ESSENTIAL TO MAINTAIN A REASONABLY HIGH GROWTH RATE. THUS, AS IN DEALING WITH INFLATION, GOM IS CONSTRAINED IN EFFORTS TO REDUCE CURRENT ACCOUNT DEFICIT BY ECONOMIC GROWTH RATE OBJECTIVES.

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4. MEXICO WILL HAVE TO OBTAIN EXTERNAL FINANCING OF AT LEAST \$4 BILLION IN 1975 (\$3.5 BILLION PLUS PUBLIC SECTOR DEBT AMORTIZATION PAYMENTS OF \$850 MILLION MINUS DIRECT INVESTMENT INFLOWS.) DRAWDOWNS OF LOANS FROM THE INTERNATIONAL FINANCIAL INSTITUTIONS AND OFFICIAL LENDING AGENCIES ARE UNLIKELY TO EXCEED \$500-600 MILLION, THOUGH WE HAVE NO GOOD DATA ON THESE. MEXICO WILL HAVE TO TURN TO PRIVATE SOURCES FOR THE BALANCE UNLESS IT DRAWS ON ITS

PRIMARY AND SECONDARY RESERVES. THUS, MAINTAINING PRIVATE INVESTOR CONFIDENCE IS EXTREMELY IMPORTANT.

5. THERE DOES NOT APPEAR TO HAVE BEEN ANY GENERAL LOSS OF CONFIDENCE ON THE PART OF FOREIGN INVESTORS AND BANKERS, NOR ANY RUSH TO BUY DOLLARS AS DEVELOPED LAST AUGUST PRIOR TO THE PRESIDENT'S SEPTEMBER 1 INFORME. WE HAVE, HOWEVER, HEARD INDIRECTLY THAT SEVERAL FOREIGN BANKS HAVE SAID THEY WOULD NOT PARTICIPATE IN NEW LOANS FOR MEXICO UNTIL THE PRI PRESIDENTIAL CANDIDATE IS SELECTED LATER THIS YEAR. THIS REFLECTS SOME CONCERN OVER PRESENT POLICIES AND THE HOPE, WIDESPREAD AMONG THE BUSINESS COMMUNITY, THAT THE PRI CANDIDATE WILL BE GOVERNMENT SECRETARY MOYA PALENCIA WHOS IS CONSIDERED MORE PRO-BUSINESS THAN THE INCUMBENT. SEVERAL PRIVATE MEXICAN BANKERS AND SOME GOM OFFICIALS HAVE ALSO EXPRESSED THEIR CONCERN TO US OVER RECENT ECONOMIC TRENDS AND POSSIBLE IMPLICATIONS. THE PRIVATE BUSINESS COMMUNITY IS BEGINNING TO HEAR OF WORRIES OVER RECENT ECONOMIC DEVELOPMENTS AND ARE BEGINNING TO ASK MORE QUESTIONS. AS A GROUP, THEY HAVE BEEN ALIENATED BY THE RHETORIC AND ECONOMIC POLICIES OF THIS ADMINISTRATION, AND SEEM TO BE IN A STATE OF SUSPENSION AWAITING THE SELECTION OF THE PRI CANDIDATE WITH FINGERS CROSSED.

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ACTION ARA-06

INFO OCT-01 SS-14 ISO-00 NSC-05 NSCE-00 INR-05 CIAE-00

EB-03 SP-02 OMB-01 PRS-01 /038 W

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R 132115Z AUG 75

FM AMEMBASSY MEXICO

TO SECSTATE WASHDC 9408

C O N F I D E N T I A L SECTION 2 OF 2 MEXICO 7205

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6. GOM CONCERN WAS MANIFESTED DURING AMBASSADOR DENT'S VISIT WHEN TREASURY SECRETARY LOPEZ-PORTILLO ASKED HIM TO MAKE SOME PUBLIC COMMENTS INDICATING CONFIDENCE IN THE

ECONOMY. THE DAY BEFORE, THE AMCHAM'S ECONOMIC ADVISOR GAVE A SPEECH IN WHICH HE SAID THAT IF INFLATION CONTINUED AT A RATE EQUIVALENT TO THAT OF THE PAST FEW MONTHS AND THE RATE OF INFLATION IN THE U.S. REMAINED AT OR BELOW THE RATE OF THE FIRST HALF OF THIS YEAR, A DEVALUATION WAS INEVITABLE. WE HAVE SECOND-HAND REPORTS THAT THE GOM TRIED (BUT FAILED) TO SUPPRESS PRESS REPORTS OF SPEECH, AND PRESUME LOPEZ-PORTILLO WAS ANXIOUS TO HAVE AN AMERICAN OFFICIAL OFFSET THESE REMARKS. ON AUGUST 11, LABOR LEADER FIDEL VELASQUEZ REPORTEDLY SAID THAT A DEVALUATION COULD RESULT FROM THE CURRENT INFLATION.

7. PUBLIC DISCUSSION AND ANALYSIS OF RECENT ECONOMIC TRENDS IN MEXICO COULD TARNISH THIS COUNTRY'S IMAGE AS BEING WELL MANAGED ECONOMICALLY. IN THE PAST SEVERAL YEARS THE GOM HAS BLAMED ITS ECONOMIC PROBLEMS ON EXTERNAL FACTORS AND, IN THE CASE OF INFLATION, THIS WAS PARTIALLY TRUE, BUT NOT THIS YEAR. THEY CAN, HOWEVER, BLAME THE U.S. RECESSION FOR PART OF THEIR BALANCE OF PAYMENTS PROBLEMS. AS ONE OF THE MAJOR FACTORS CITED BY BANKERS AND OTHERS AS REASONS FOR INVESTING HERE IS THE HIGH COMPETENCE OF MEXICO'S ECONOMIC OFFICIALS, PARTICULARLY IN THE BANK OF MEXICO, PUBLIC CRITICISM OF POLICY COULD HURT. AS IT IS, THE BANK
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OF MEXICO REMAINS COMPETENT. UNFORTUNATELY, ITS INFLUENCE ON POLICY DECISIONS HAS DIMINISHED.

8. THERE ARE SEVERAL POSSIBLE SCENARIOS FOR THE NEXT SIX MONTHS. ONE IS THAT THE ECONOMY WILL MUDDLE THROUGH. SOME RESTRAINTS ON SPENDING COUPLED WITH PRICE INCREASES FOR PUBLIC UTILITIES WILL BE INTRODUCED. BANKERS WILL REMAINS CONFIDENT FOR THE MEDIUM TERM AND WANT TO PROTECT THEIR INVESTMENTS HERE IN THE SHORT-TERM SO WILL PROVIDE ALL OR PART OF THE FUNDS MEXICO NEEDS. FINALLY, SELECTION OF THE PRI PRESIDENTIAL CANDIDATE WILL RESTORE SOME CONFIDENCE ON PART OF THE PRIVATE SECTOR SO THAT PRIVATE INVESTMENT WILL BEGIN TO PICK UP. A SECOND SCENARIO IS THAT FOREIGN BANKERS WILL BACK OFF IN MEXICO, AND THE LOCAL POPULATION WILL START A RUN ON THE PESO, FORCING EITHER A MAMMOTH RESCUE OPERATION FOR THE PESO OR A DEVALUATION ACCOMPANIED BY MORE DRASTIC ECONOMIC POLICY REFORMS IMPOSED AS A STABILIZATION PROGRAM BY THE IMF. THERE COULD BE REQUESTS FOR USG FINANCIAL ASSISTANCE IN EITHER OF THESE TWO SCENARIOS. A THIRD SCENARIO IS THAT THE PRESIDENT RETURNS FROM HIS TRIP IMBUE WITH THIRD WORLD RHETORIC, DISMISSES MEXICO'S "GROWTH WITH STABILITY" POLICIES AS INADEQUATE TO COPE WITH THE PRESENT SITUATION, AND BLAMES MEXICO'S ECONOMIC PROBLEMS ON THE INDUSTRIALIZED COUNTRIES. RATHER THAN TAKE MEASURES TO DEAL WITH THE BASIC

PROBLEMS, HE ATTEMPTS TO PAPER OVER THE SITUATION WITH SUCH MEASURES AS MORE STRINGENT PRICE CONTROLS, EXCHANGE RESTRICTIONS, MULTIPLE EXCHANGE RATES, DEBT RESCHEDULING. THESE MEASURES WOULD, PERHAPS DELIBERATELY, FURTHER ALIENATE THE PRIVATE BUSINESS SECTOR AND REQUIRE A GREATER ROLE FOR THE PUBLIC SECTOR. ALSO, HAVING MADE A DRAMATIC BREAK WITH THE PAST, THE INCUMBENT WOULD PROBABLY ATTEMPT TO SELECT A SUCCESSOR THAT WOULD BE SYMPATHETIC TO A NEW AND MORE RADICAL SET OF ECONOMIC POLICIES. THIS SCENARIO, IS, OF COURSE, REplete WITH POLITICAL AS WELL AS ECONOMIC CONSEQUENCES.

9. AT THIS POINT, WE WOULD OPT FOR THE FIRST OPTION AS THE MORE LIKELY, BUT BELIEVE THE CHANCES OF THE SECOND OPTION BECOME GREATER WITH EACH DAY THAT PASSES WITHOUT ADOPTING CORRECTIVE POLICIES. THE THIRD MAY BE REMOTE, CONFIDENTIAL

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BUT SHOULD NOT BE COMPLETELY RULED OUT. IN ANY CASE, ECONOMIC PROBLEMS WILL BE A MAJOR SUBJECT OF DISCUSSIONS BETWEEN THE PRESIDENT'S RETURN AND HIS INFORME ON SEPTEMBER 1. JOVA

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Message Attributes

Automatic Decaptioning: Z
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: PRESS COMMENTS, ECONOMIC ESTIMATES, ECONOMIC PROGRAMS, PUBLIC ATTITUDES
Control Number: n/a
Copy: SINGLE
Draft Date: 13 AUG 1975
Decaption Date: 28 MAY 2004
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: GolinoFR
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1975MEXICO07205
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Film Number: D750280-0352
From: MEXICO
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1975/newtext/t19750857/aaaabxpc.tel
Line Count: 250
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION ARA
Original Classification: CONFIDENTIAL
Original Handling Restrictions: LIMDIS
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 5
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: LIMDIS
Reference: 75 MEXICO A-298, 75 MEXICO 7040
Review Action: RELEASED, APPROVED
Review Authority: GolinoFR
Review Comment: n/a
Review Content Flags:
Review Date: 11 SEP 2003
Review Event:
Review Exemptions: n/a
Review History: RELEASED <11 SEP 2003 by izenbei0>; APPROVED <05 NOV 2003 by GolinoFR>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
06 JUL 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: MOUNTING CONCERN OVER MEXICOS ECONOMIC PROSPECTS
TAGS: EFIN, EGEN, MX
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 06 JUL 2006